

F&C's Mahtani: Next decade "will belong to India"



Whilst the strong economic development in China dominated headlines over the last decade, F&C's Sam Mahtani believes that the next decade will belong to India.

Economic growth in India has been on an upward trend over the past two decades. As such, Mahtani anticipates that growth will continue to accelerate this decade, moving above 9%pa, and that India will likely overtake China to become the fastest growing economy in the world during the next five years.

Over 50% of India's population are under 25 and highly aspirational, providing a vast consuming class which Mahtani believes should drive domestic demand. Elsewhere, he anticipates that the accelerating savings ratio could provide financing for the Government's big infrastructure programme and potentially lead to a large increase in domestic equity investments, an area to which so far Indian households have had a low exposure.

Mahtani commented: "Following chronic underinvestment in infrastructure in the last decade, the new Indian Government's ambitious spending plan for the coming decade – an impressive \$1.7 trillion – will act as a key driver of economic growth in areas that clearly need investment, such as power and railways. They have also restarted the privatisation programme with a number of companies in the public sector coming to the equity market, attempting to emulate the successful UK privatisation programme of the 1980s and 1990s, to attract retail investors."

Foreign Domestic Investment (FDI) is another key area where India has enjoyed recent success. India is catching up with China, following the deregulation of a number of sectors, and Mahtani estimates that by 2011 FDI will be around US\$30bn, a substantial increase from the US\$1.5bn India received in 1995.

Mahtani anticipates that these combined positive elements should see India enter a new phase of earnings growth and expects earnings growth of at least 20%pa for the next few years.

Whilst he remains positive on a medium to long-term outlook, Mahtani cautions that investors need to be selective when identifying themes and stocks.

"Metals & Mining is one area which should benefit from robust demand led by infrastructure

growth and higher consumption for most metals as consumer demand grows. I also see a huge opportunity in Financial Services – there are over 1 billion people in India but only 50 million bank accounts and 20 million credit cards. There is massive potential for growth across the product ranges. Pharmaceuticals is another key theme, with Indian drugs companies well positioned to benefit from expertise, low cost base and integrated business models," Mahtani concluded. Mahtani highlights Jindal Steel & Power, Ranbaxy and Axis Bank as high conviction stock ideas in India.

F&C Japan desk gets vote of confidence from world's oldest investment trust

Foreign & Colonial Investment Trust (FCIT) has brought management of its Japan portfolio back in-house to F&C Investments, almost five years after outsourcing it to Goldman Sachs Asset Management (GSAM).

At the time of the outsource deal in 2005, F&C's Japan desk had performed poorly for some time and FCIT manager Jeremy Tigue took the decision to place the portfolio with quantitative manager GSAM. But with the in-house team now ahead of the sector median performance over one, three and five years, Tigue has decided to switch the portfolio back to F&C to take advantage of the greater flexibility offered by an active investment management approach. Although still broadly negative in his view of Japan, Tigue said: "The point is that after 20 years of underperformance, at some stage Japan will have some good performance, and by making this change we're more likely to be able to spot this and do something about it."

Head of Japanese equities Jamie Jenkins joined F&C in 2004 following the merger with ISIS Asset Management, and was promoted to his current role in early 2007. He heads a team of three, working alongside fund managers Stefan Bain, who joined F&C in 2007, and Mark Perrin, who moved on to the Japan desk in 2006 having previously worked in the Pacific Equities team. The Japan team are high-conviction stockpickers, focused on creating portfolios of 'best ideas' drawn from the 4,000 or so companies listed in Japan. The managers use a thematic approach to pinpoint key medium-term investment opportunities, and strive to identify where the market consensus is wrong, either through mispricing a company in relation to its earnings outlook or incorrectly forecasting those earnings.

Jenkins said: "As a market, Japan offers large inefficiencies for stockpickers to exploit, and we fully intend to do just that on behalf of FCIT." He points out that Japan is the largest, most diversified market in Asia, with world-class companies in a variety of sectors, and is increasingly geared into growth in the emerging markets of Asia, with exports from Japan to the rest of Asia now totalling more than exports to the US.

In addition, the structural underweight of many global funds towards Japan shows some signs of unwinding, which Jenkins said could have a "huge positive impact" on the Japanese stockmarket if this trend gathers pace. Although Japan is popularly perceived as having

been in the doldrums since the market crash of 1989, Jenkins said the market has actually performed better than people think, moving in line with global indices since 1999. This makes for an attractive risk/reward profile at this point in the cycle, he added.

Jenkins concluded: "We are a stable and very enthusiastic team who have what we think is a sound investment process. We are committed to Japan and we think we can add a lot of value there."

Selective risk/return opportunities remain in High Yield

With a steeper yield curve and expectations of a rapidly improving economic recovery, many strategists are making a case for equities in 2010. However, whilst the return potential of equities can be greater than that of high-yield bonds, the risks can equally be greater.

F&C's High Yield team is of the view that global GDP growth is likely to remain volatile in 2010, with some experts anticipating the return of shorter, more dramatic business cycles. To prepare for this environment, companies are conserving cash flow and reducing leverage, encouraging tepid growth at best. Slower post-recession growth and lack of earnings visibility, combined with a higher cost of capital, is likely to place pressure on equity valuations and their return potential. Furthermore, the expectation of higher interest rates also supports the case for high yield as the asset class typically performs well amidst rising interest rates, whilst equities have a higher degree of sensitivity in this environment.

As a result, the team believe that better balance sheet management is more supportive of credit and high yield is a particularly "sweet spot", offering investors the opportunity to achieve attractive risk-adjusted returns.

Fatima Luis, who manages the F&C Maximum Income Bond Fund, a specialist high yield fund, commented: "We have taken a number of steps unique to high yield to take advantage of this environment. We moved away from low coupon and high duration issues to mitigate interest rate risk and increased positions in secured bonds at the higher part of the capital structure, giving us access to better quality positions without sacrificing the yield. In addition, we remain overweight in subordinated financials and insurers, which should continue to perform as liquidity and fundamentals improve."

Luis has also been adding to the US high yield exposure in the fund, currently favouring the US over Europe as macro indicators appear to support a healthier economic picture for the region; they are not entirely out of the woods, however Europe has a longer journey ahead. "Government debt over the next few years is likely to weigh down on growth and economic recovery will be muted as a result. Despite this, the corporate sector has not suffered as much as anticipated at the height of the crisis and in the medium term high yield continues to offer excellent risk/return characteristics," Luis concluded.